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SUBJECT: KAZAKHSTAN: CONOCOPHILLIPS' "N BLOCK" BID ON HOLD

REF: 06 ASTANA 738

Classified By: Ambassador John Ordway; Reasons 1.5 (b) and (d).

¶1. (C) Summary: Don Wallette, ConocoPhillips' (CP) Russia and Caspian Region President, told the Ambassador on February 28 that the GOK had decided to postpone, indefinitely, its selection of foreign partners to participate in the development of the offshore "N" block, in order to re-evaluate the reservoir in light of indications that the block's reserves are larger than previously assumed. This unexpected news follows high-level GOK assurances in December, given both to CP and the Ambassador, that CP would be given an initial 10% stake in the project, with the details of CP's partnership with Shell and KazMunaiGaz (KMG) to be worked out in early 2007. According to Wallette, CP's main rival for the project, Shell, has received the same bad news, leaving both companies in a state of uncertainty.

¶2. (C) Summary (continued): Discussing Kashagan, Wallette noted that ENI's recent announcement of a late 2010 date for "first Kashagan oil" was still "somewhat optimistic"; a late-summer 2007 engineering review might bring more certainty. Wallette explained that the North Caspian PSA partners were increasingly interested in bringing Kashagan's sister field, Kalamkas, online in the short term, even before first Kashagan production. ENI was receptive to the idea of another consortium partner operating Kalamkas, Wallette explained, and Shell had approached CP with a joint operatorship proposal. However, Wallette concluded, given CP's small stake (9%) in the consortium, and Kalamkas's relative insignificance in CP's global portfolio, the company was unwilling to make the personnel commitments required of an operator. End summary.

N Block: Back to Uncertainty

¶3. (C) Wallette informed the Ambassador on February 28 that CP had recently been notified that, due to KMG's desire to re-evaluate the "N Block" reservoir, further negotiations on CP and Shell's participation in the project would be postponed, "perhaps until May or June." (When CP first learned of the postponement, KMG sources told CP Country Manager Nick Olds that Kashagan delays had triggered a broad GOK review of its offshore Caspian development plans; later, however, CP received a more authoritative explanation: that the GOK had reason to believe that "N" Block reserves were larger than previously thought, and wished to re-evaluate the available seismic data.) Olds told the Ambassador that, as far as CP knew, KMG had not acquired any new data; rather, it would re-interpret existing data. (Earlier in the week Olds

speculated to Energy Officer that perhaps KMG had acquired new data from Chevron, which has been undertaking seismic data collection over a broad portion of the Caspian, overlapping "N" -- but by February 28 Olds seemed to have dismissed the possibility that Chevron's study had provoked the decision.)

¶4. (C) Wallette termed the GOK stance "an abrupt change," recalling that CP had received clear notice in December, both from Energy Minister Izmukhambetov and Presidential son-in-law Timur Kulibayev, that CP would receive an initial 10% share of the project, and partner with both Shell and KMG; further, CP had been told that detailed negotiations among the three partners, leading to signature of a "Heads of Agreement" (HOA), would commence in January. While Mulva had not accepted that CP would receive only 10%, arguing instead for a 20% (CP), 20% (Shell), 60% (KMG) initial split, the company had weathered the delays caused by the January change of government fully expecting to reach closure on a deal soon after. (Note: On December 15, both Izmukhambetov and Prime Minister Akhmetov told the Ambassador, as well, that CP would get an initial 10% of "N." The same day, President Nazarbayev also informed the Ambassador that CP would be included. End note.)

¶5. (C) Wallette noted that "N" block rival -- and potential partner -- Shell had also been caught off-guard by the announcement; Shell's Country Manager, Martin Ferstl, had called Olds in an attempt to understand the GOK's decision. (Olds reported that a KMG source had told him that, upon hearing the news, Prime Minister Blair had called Nazarbayev, only to be told the same thing -- that KMG was re-evaluating the field.)

ASTANA 00000562 002 OF 002

¶6. (C) Olds told the Ambassador that KMG sources had informed him that the GOK's "N" block strategy was dependent on the outcome of the reevaluation. If the reserve estimates grew substantially, the GOK would either launch an entirely new tender process, split the block in two and run separate tenders -- or, conceivably, "stay the course" with Shell and CP. Ambassador Ordway raised the possibility that this latest news was (another) GOK tactic designed to squeeze the maximum amount of money out of Shell and CP before going forward. Did it not make sense, he asked, for Shell and CP to join forces, both to consolidate their position and to eliminate the possibility of being played off against one another? Wallette and Olds agreed that it was time to re-evaluate CP's strategy, and that approaching Shell with such an offer was certainly worth another look.

Kashagan: Kalamkas Oil First?

¶7. (C) Turning to Kashagan, Wallette suggested that operator ENI's recent announcement that first oil would be delayed until 2010 "meant December 31, 2010," and, even at that, was still "somewhat optimistic." The consortium would likely know more by the end of the summer, he said, after further engineering work was done. Wallette added that the consortium would have to provide the GOK with a revised development plan and budget during the summer -- which would likely provoke a "tough" GOK reaction.

¶8. (C) Wallette told the Ambassador that a recent appraisal well at Kashagan's sister field, Kalamkas, had been "very successful." Furthermore, he said, unlike Kashagan, Kalamkas gas was "sweet," making overall field development "no harder than routine North Sea work." As a consequence, the consortium partners were seriously considering bringing Kalamkas oil to market early, ahead of Kashagan first oil. ENI, Wallette added, was open to the idea of appointing a sub-contractor as Kalamkas operator, so long as the field remained under the Kashagan Production Sharing Agreement, and so long as the operator adhered to the current development

concept -- i.e., so long as Kalamkas oil was produced early, in order to help compensate for Kashagan delays. (Walette pointed out that accelerating the date of Kalamkas production was not necessarily the best economic decision.)

¶9. (C) Shell had approached CP with a proposal to jointly operate Kalamkas, Walette said. Given their respective shares in the AGIP KCO consortium, and Kalamkas's relatively small size, neither company wanted to operate alone. In fact, Walette added, CP had turned down Shell's offer, unwilling to commit large numbers of its skilled personnel to operate what was, in global terms, a relatively insignificant project. The CP executives reported that ExxonMobil was also rumored to be a candidate for the Kalamkas operatorship.

¶10. (C) Comment. The GOK's decision to delay a "N" Block deal is, of course, disappointing. It is also mysterious -- is there, in fact, new seismic data? Is this move a GOK ploy to squeeze more money out of CP and Shell, or perhaps to introduce new partner companies into the deal? However, it is too early to assume that the GOK's promise of 10% CP participation has been broken. While CP may find itself forced to raise its offer in the face of new reserve estimates, or even match another company's better offer in order to secure its promised 10%, we continue to take some comfort, at least, in the high-level promises made in mid-December. End comment.
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